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UPDATE FOR 1982 INCOME TAX RETURNS

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Income tax filing will shortly begin. While the time is past for calendar year taxpayers to do much tax management, there are still a number of tax law changes of which you need to be aware for filing your 1982 income tax returns. Some of these are on the personal part of your return, and there are a few changes that you need to be aware of that will affect your 1983 tax returns.

PERSONAL ITEMS

Tax Rates -- Income tax rates for 1982 are about 9% under last year. The current law calls for an additional 10% cut in 1983.

Two-Earner Married Couple -- Two-earner married couples who file a joint return will be allowed a deduction from gross income on their 1982 tax returns. Taxable income may be reduced by 5% of the income of the spouse earning the least. The maximum deduction is $1,500 in 1982; i.e. 5% of $30,000. Next year the rate is 10% and the maximum deduction is $3,000.

However, wages earned by one spouse working for the other are excluded from "qualified earned income". No deduction is allowed on this income.

Dividend Exclusion -- In 1982, only $200 of dividends may be excluded from income on a joint return. No interest may be excluded other than interest on all savers certificates and approved individual retirement accounts (IRAs).

Contributions, Non-Itemizers -- In 1982, persons who make charitable contributions but do not have enough itemized deductions to file a schedule A, will be able to take a deduction on their Form 1040 for up to $25. The maximum contribution that will be allowable for 1982 is limited to 25% of the first $100 of contribution or the $25. This will increase in later years. In 1986, all contributions will be deductible on your tax return, even though you do not itemize your other deductions.

IRAs -- Beginning with 1982, nearly any individual with earned income can put up to $2,000 into an individual retirement account (IRA) and this amount can then be deducted from taxable income for the year. In addition, if one of the spouse's did not have any income of their own, a total of $2,250 may be put into an IRA and up to $2,000 may be credited to either spouse. Also, if both spouse's have earned income they may each put up to $2,000 into an IRA. In any case the amount contributed to the IRA may not exceed the amount of earned income for the year. Some farm families who are interested in having the spouse have a separate IRA may wish to begin making payments from the farm business to the spouse for their work in the farm business. For example, if a wife normally keeps the records in the farm business, it may be reasonable to pay her a certain amount each month for the time spent working on the records. If this amounted to $2,000 for the year then she would be able to take that full amount and put it into an IRA if she so desires. However, as noted earlier, this is not considered earned income for purposes of the two-earner married couple exemption. Neither is it subject to Social Security tax.

BUSINESS ITEMS

ACRS and ITC -- This is the second year of the new system of depreciation known as Accelerated Cost Recovery System or ACRS. The ACRS depreciation rules for 1982 are unchanged from last year. However, this year's depreciation bite will be bigger on items which were placed in service last year. For example, the depreciation rate was 15% on a tractor and all other 5 year class items placed in service in 1981 if you chose to use the accelerated rates. This year's rate will be 22% on these 1981 purchases and the rate in each of the next three years will be 20%. If the 5 year straight line election was taken in 1981, the percentage was 10% for 1981 and 20% for 1982. You may need to study carefully your depreciation deductions on any 1982 purchases, especially if 1982 was a low income year and you anticipate another low income year in 1983. Once you make a choice on a particular group of assets you are not allowed to change the depreciation method on those assets in later years. Therefore, you may be wise to choose a longer period of years with a straight line rate to defer depreciation to later years of higher income or to have a higher basis when you trade in that equipment on some new equipment four or five years from now. If you are unable to use depreciation in any given year to offset income from your farm business it is wasted because you cannot carry over depreciation and use it a later year.

Also remember that with 15 year property such as machine sheds you should probably use the straight line ACRS method and recover that cost over 15 years. Why? Use of ACRS means all gain will be ordinary income, to extent of depreciation, when sold. You will get a little less depreciation now, but your tax savings on sale can be great.

There is also a continuation of the new investment tax credit system that came into being with the ACRS depreciation system. All property purchased in 1982 is eligible for a 6% investment tax credit if it is 3 year property and a 10% investment tax credit on other eligible property. However, if you purchased equipment from a relative, property you previously leased, or under one of the other rules that would disqualify it as recovery property, you cannot take investment credit and you must claim depreciation under the rules that existed prior to 1981. In addition, any recapture of investment credit on assets purchased prior to 1981 must be determined using the old investment credit rules.

Expense Deduction -- Up to $5,000 of qualified capital purcahses may be recovered as a current expense in 1982. Limits on the amount which can be expensed in the years ahead are as follows: $5,000 in 1983; $7,500 in 1984 and 1985; and $10,000 in 1986 and after.

Items eligible to be expensed include ACRS property in the 3 year and 5 year classes, but not horses and not property acquired from close relatives. You also need to consider whether taking this expense deduction is really in your best interest. While it does allow you to defer a greater amount of tax in the year you take the expense deduction, you will lose the investment credit on the amount expensed. Thus, writing off $5,000 via the expense deduction in 1982 means that you have forever lost $500 of investment tax credit on that amount of capital purchase. Our analysis suggests that the primary individuals who would benefit from making use of this are those who have experienced an extremely profitable year in 1982 but expect that later years will not be as profitable and thus they want to offset the tax while they have the opportunity. In addition, others may want to use the expense deduction simply because it is more convenient to write off several small capital purchases maybe in the $500 to $1,000 range rather than carrying them on the depreciation schedule over time.

Credit for Qualified Rehabilitation Expenditures -- The revised version of the credit for qualfied rehabilitation expenditures allows a 15% investment tax credit for rehabilitating qualified buildings that are 30-39 years old, a 20% investment tax credit for rehabilitating qualified buildings 40 years old or more, and a 25% investment tax credit for rehabilitating certified historic sites. Rehabilitation means to remodel a building for use in the business. Specific rules must be followed to qualify as rehabilitation. And the total expenditure must be at least the greater of $5,000 or the remaining basis of the building. The rehabilitation must be on a property that is used in a business and it must be for a business purpose. Expenditures must be capitalized with a 15 year recovery period and depreciation must be figured by the straight line ACRS method. In addition, the basis of the property must be reduced by the amount of investment credit taken before figuring the basis that will be depreciated over the 15 year period. As yet IRS has not stated whether or not agricultural buildings qualify for this credit, but it seems prudent to go ahead and claim this credit since at the present time there is no reason to say that it should not qualify.

Income Averaging -- For some farmers 1982 was a high income year. If this is the case you may need to take a look at Schedule G, Income Averaging, and see if you may be able to reduce your total tax bite when you average it out in comparison with the four previous years of taxable income.

Net Operating Loss -- There are also other farmers for whom 1982 was a disastrous income year. If your Schedule F shows a large negative value, you may want to consider filing a net operating loss or NOL. If you have an NOL in a given year you may carry the net operating loss deduction to prior years and offset taxes that you have previously paid or carry it to future years and offset taxes that will be liable in the future. An NOL can be carried back three years and ahead fifteen years.

Calculating an NOL is not a simple task. It first requires making adjustments to the current return to see exactly how much of a loss occurred as a result of your business activities. This loss figure is then carried back to the third year prior to the current year and you need to make adjustments on that return to get a refund on taxes paid in that year. If part of the NOL deduction still remains, you can then carry it forward to two years ago, to last year, and then forward up to as many as 15 future years. Do not dismiss the NOL merely because it appears time consuming or you are afraid you'll have to pay a tax preparer several hundred dollars to have the computation made for you. If you have paid taxes in prior years the cost of having the NOL computations done may generate several times as much income as the cost of computing the NOL. One final point, if you have a net operating loss in 1982, but do not have any tax payments in prior years or they are so small you do not want to bother with them, you can elect to merely carry that NOL forward and use it to offset income in future years. However, you must make this election on a timely filed return in order to only carry that NOL forward.

Carryover ITC and NOL -- In computing your current years tax return, be sure to take advantage of any unused investment tax credit, energy tax credit, or net operating losses earned in prior years but not yet used.

Government Program Payments -- 1) Deficiency payments, diversion payments and storage payments in connection with reserve loans are all reportable as income in the year in which they are received. If you signed up for the 1983 government program in corn and/or wheat and received an advance payment on the deficiency and diversion payments under that program, you must also include the advance payments in your 1982 income. In addition, if you signed up for the 1983 program, but elected not to receive that income until 1983, the present understanding is that you will also have to count the value of these advance payments as 1982 income. The reason is that if you signed up for the program, you had the opportunity to receive that income in 1982 and under previous rulings, this would be treated as constructive receipt of income and would be classified as 1982 income. Hopefully, this will be worked out between the ASCS and IRS and when you receive your 1099 from ASCS it will indicate the amount that you will have to report on your 1982 tax return.

2) CCC loans. The general rule on CCC loans is that the income is to be reported in the year in which the crop is sold or forfeited to the government. However, you do have an election to report that income in the year when the loan proceeds are received. So if you took out a loan for soybeans in the fall of 1982 and decided that you would prefer to have that income shown on your 1982 tax return you can elect to do that. The problem is that once you elect to treat a CCC loan as income at the time you get the loan proceeds, then it applies for all succeeding years. Therefore, if in 1981 (or some previous year) you elected to treat a CCC loan as income at the time you got those loan dollars, then you must also treat any loans that you took in 1982 in that same manner.

Standard Mileage Deduction -- Where only one vehicle is used for business purposes or where two vehicles are used on an alternating basis, the taxpayer has the option of claiming a standard mileage deduction on the business miles driven. The standard mileage rate method is an optional method for computing the deductible amount of car expenses incurred for business purposes. In 1982 this remains at 20¢ per mile for the first 15,000 business miles and 11¢ per mile for any business miles in excess of 15,000 miles. Once 60,000 business miles have been claimed for any vehicle, it is assumed to be fully depreciated, and only the 11¢ per mile deduction is available. This amount is in lieu of all operating and fixed costs of the car allocable to its business uses, such as gasoline and oil costs, repair and maintenance costs, insurance expenses, and depreciation.

The standard mileage rate method cannot be used for a car first placed in service for business purposes after December 31, 1980 unless the taxpayer has elected such method for the first year the car is placed in service. However, a taxpayer who has elected the standard mileage deduction in the first year, has the option in each successive year to use either the standard mileage rate method or the expenses actually incurred to determine the amount of his deductions. This has come out in a recent revenue ruling from IRS, and you would need to contact IRS for further information on how you might take advantage of this option.

The election to use actual expenses beginning with the year the car was placed in service would merely follow the same as any other item of business property. In other words you would set the car or truck up as a business vehicle on your depreciation schedule as 3 year property, take a 6% investment credit on that vehicle, and then keep track of the actual expenses for fuel, insurance, repairs, etc. and enter them as business expenses. Naturally, if a car is half used for business and half used for personal, you need to allocate the business expense and only claim the allowable deductions for the business.

Form 1099 Filings -- Several types of information returns or Form 1099's must be filed if you paid more than $600 in a year to an individual for an expense within your business. For example, Form 1099-NEC is a statement for recipients of non-employee compensation. If you paid at least $600 in fees, commissions, or any other form of compensation to someone who is not your employee, then you are required to file a 1099-NEC and report that payment to the government and also send a copy of that form to the recipient of that payment so that he knows it has been reported. Types of payments that would qualify here are payments to an attorney for legal services, payments to an independent contractor to remodel or paint a building, payments to a farm manager to manage the farm, payment to an unincorporated veterinarian for his services, or payment to a neighbor for custom work that he performed for you. Services performed for your business - by an unincorporated business - for which you paid at least $600 during the year must be reported on a 1099-NEC.

Other 1099's which you may have to file include a Form 1099-MISC. This is a statement for recipients of miscellaneous income and generally applies to rents, royalties, and similar payments. The most common one would be where you have paid more than $600 in cash rent to the landlord during the year.

You are responsible for filing these 1099 statements and there will be a $50 penalty per statement for failure to file these returns with IRS. Thus, in 1983, if you are required to file six such statements and failed to do so, you can be penalized $300. The intent is to obtain compliance in filing these information returns, just as you file W-2's for business employees.

How do you go about filing these returns? On the inside back cover of your Farmer's Tax Guide is an address for requesting additional forms. You will need to contact IRS and request them to send you copies of the 1099-NEC, 1099-MISC, and any other 1099's that you may need as well as a copy of a Form 1096. The Form 1096 merely summarizes the number and type of these forms that you are submitting to IRS. Unfortunately, at this point IRS does not include any of the 1099 or 1096 forms as a part of your tax return packet. Hopefully, this will be corrected in the future, since you are subject to penalty for not filing these returns.

Futures Contracts -- Persons involved in the purchase and sale of commodity futures contracts need to visit with your broker and make sure that you are following the rules and that you are either hedging or speculating, whichever you are trying to do with these commodity futures contracts. If you are involved in the purchase of futures contracts and are trying to hedge then you need to be sure that you note on the date you initially purchase or sell that contract that you are involved in this for the purpose of hedging. If you do not make such a notation, even though your actions can be documented and shown it would be for the purpose of hedging, IRS may disallow this and require you to treat it as a speculative transaction. In addition, if you are in fact speculating in the futures market, then you also have to file a Form 6781 along with your tax return. This essentially treats each contract that you held at the end of calendar year 1982 as being closed out at that point for tax purposes. If you are involved in the purchase or sale of commodity futures contracts, be sure to study the tax rules regarding this so that you can comply and won't be penalized simply because of a failure to understand the rules.

Optional Method of Self-Employment Tax -- Farmers who have little or no income may feel that it is a good time to skip paying anything on their self-employment tax. However, I would recommend that most farmers and especially young, farm families file their Schedule SE and pay the small amount of self-employment tax using the farm optional method. This will cost you very few dollars but in case of an accident or disability or death of the farm operator, it could be worth very many dollars in terms of disability benefits or income benefits to you and/or to your family.

1983 CHANGES

Basis/Investment Tax Credit Tradeoff -- Any property that you place in service in 1983 will be handled differently relative to the amount of basis and investment credit that you can obtain. In essence, for purchases in 1983 and later years you will have two choices; 1) you can reduce the basis of the property for depreciation by ½ of the tax credit claimed, or b) reduce the tax credit claimed by 2% (i.e., claim 4% credit on 3 year property and 8% credit on 5 year property).

Thus, there will be either less depreciation or less investment credit on future purchases of capital items for use in your business.

Casualty Losses -- After 1982, uninsured casualty losses to individuals will be deductible only if they exceed $100 per casualty plus 10% of your adjusted gross income. Currently there is no limit after the first $100 of casualty loss. This will mean that it will be much more difficult for major losses in the future. This may be a good time to check your casualty loss coverage to make sure that it is adequate on your personal property items.

Medical Expenses -- It will also be more difficult to claim a deduction for medical expenses starting in 1983. In 1983 medical expenses can only be deducted when they exceed 5% of your adjusted gross income, compared to the current 3% figure. In addition the $150 insurance deduction has been eliminated. Also, starting in 1984 the 1% floor on prescriptions will be eliminated. The net effect of all of these is that it will take a larger amount of medical expense before individuals will have a deductible expense claim.

SUMMARY

This has been a brief overview of some of the major changes that will effect the 1982 return and a look at 3 changes that are going to effect your 1983 tax return. For further information on these and other changes please consult the 1982 Farmer's Tax Guide. You may also want to obtain other publications from IRS such as Publication 17, Your Personal Income Tax and Publication 334, Tax Guide for Small Business.

** Letter Study Course Corrections **

Key to Review of Lesson 7, Question 5. (Page 10 of Lesson 8)

b) Sale Price $7,000 - Cost $6,500 - Depreciation $975.
= Total Gain of $1,475 (L. 17).

c) L. 18a Depreciation of $975. Smaller of L. 17 or
18a is $975 ordinary income.

The material in this update is based on my understanding of current tax laws. Check details with IRS publications and other sources.